Agenda Item No. 6

METROPOLITAN
TRANSPORTATION
COMMISSION

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Memorandum

TO: Operations Committee DATE: May 1, 2009

FR: Executive Director W.I.

RE: TransLink® Contract: Commission Approval

(i) Assignment Agreement and Related Transactions - MTC, Motorola, Inc.; Vix ERG Ltd.; and Cubic Transportation Systems, including Settlement of *MTC v. Motorola*, Case No. C 07-15576, 9th Cir (Commission Approval)

(ii) Contract Revisions: Change Order No. 120: Cubic ($34.7 million)

Summary

Since the public launch of TransLink® on AC Transit and the Golden Gate Bridge, Highway & Transportation District on September 17, 2007, Caltrain and Muni have initiated "soft" launches with select customers. Final testing is underway at BART, with BART Revenue Ready forecast for May 8. Use of TransLink® cards has risen to a transaction volume of 600,000 per month. The public reception of TransLink® has been enthusiastic on the whole, with customers eager for the ability to use TransLink® to ride seamlessly from system to system. With the achievement of Revenue Ready status on BART, that ability will have been reached on the three largest systems in the region.

Since November 2003, when full rollout of TransLink® began, MTC has struggled with contract disputes and a lawsuit with its prime contractor, Motorola. Motorola's major subcontractor, ERG Ltd., met with financial difficulties that called into question its ability to complete the design/build phase and to operate and maintain the system through the contract term ending in 2019. In November 2008, ERG reorganized to manage its debt and potential liability from a lawsuit against Sydney Transport and is now Vix ERG, Ltd. Since then, ERG and Cubic Transportation Systems have reached an agreement for the purchase or license of the ERG assets relating to TransLink® by Cubic, subject to the occurrence of certain conditions, and have been negotiating Contract revisions with MTC staff that would allow Cubic to successfully take over the Contract, if an assignment from Motorola were agreed to. Staff and legal counsel now believe that approval of the actions before you today is the best way to preserve and build on the Commission's and federal government's investment of more than $78 million to date in the TransLink® program.

This memorandum requests that the Committee refer to the Commission for its approval:

(i) An Assignment Agreement and Related Transactions among MTC, Motorola, ERG and Cubic, that will result, when all of the conditions in the agreement are met, in the assignment of the TransLink® Contract by Motorola to Cubic and the settlement of the *MTC v. Motorola* lawsuit, including payment of MTC's attorneys' fees and costs; and

(ii) A delegation of authority to the Executive Director to negotiate and enter into a new Conformed Contract between MTC and Cubic, in the form of Change Order No. 118 (adding $1.2 million to the Contract) and additional change orders yet to be finalized, in cumulative amounts not to exceed $33.5 million. Such change orders would include the revisions described in this memorandum and its attachments.

Attachment 1 provides background for today's request, including a chronology of events relating to contract performance and Contractor responsibility. Attachment 2 includes background information concerning Cubic. Attachment 3 summarizes the key contract changes negotiated by MTC and Cubic to ensure a successful project going forward.

Assignment Agreement

The Assignment Agreement provides that the assignment of the TransLink® Contract by Motorola to Cubic will occur when a number of closing conditions have been met. These closing conditions are:

- Purchase or license by Cubic from ERG of all assets required to complete the TransLink® Contract through its 2019 term
- Execution of a Change Order revising the Contract
- Agreement between MTC and Cubic on a satisfactory transition plan
- Achievement of BART Revenue Ready (forecast for May 8)
- Resolution of the 4 outstanding claims between Motorola and MTC and settlement of *MTC v. Motorola* declaratory judgment action, with payment of MTC's attorneys' fees ($138, 695)
- TransLink® Management Group approval (approved on April 27)
- FTA notification and opportunity to exercise its right to concur
- Commission approval

A draft Assignment Agreement is currently under review by Cubic, ERG and Motorola. The final Assignment Agreement will be brought to the full Commission for its approval.

Conformed Contract

In order for Cubic to successfully assume the responsibilities of TransLink® Contractor, both parties (MTC and Cubic) required revisions and updates to the TransLink® Contract. Negotiation of the terms of the revised Contract has been underway since December 2008. The negotiated contract changes (see Attachment 3) would add approximately $34.7 million in capital costs to the current $75.8 million TransLink® Contract. The value of the operating component of the TransLink® Contract is based in part on transaction volume, which determines the variable portion of operations costs paid by the transit operators. Annual operations costs are currently at approximately $6.0 million; the estimate for annual operations costs in the last year of the contract (2019) is $22.7 million, of which $7.7 million is MTC's responsibility. The 11-year increase in operations expenditures due to the proposed contract changes is $4.1 million.

Of the $34.7 million increase in capital, an amount not to exceed $1.2 million would be included in Change Order No. 118, effective upon assignment; the remaining amount of $33.5 million is a not-to-exceed amount that would be available for change orders incorporating the contract revisions described in Attachment 4, to be finalized after assignment. Approximately $20 million of the total $34.7 million will be funded through the San Francisco Municipal Transportation Agency (SFMTA) to deliver TransLink-only equipment for the Metro system, and $14.7 million is for anticipated change orders for which funding is included in MTC's TransLink® project funding commitment in the adopted regional transportation plan (Transportation 2035). The negotiated revisions also provide for a total offset over the life of the Contract of $8.4 million, including employer program revenue and a Contractor contribution of $2 million to deliver a TransLink® application for the BART parking lots.

The Effective Date of the Conformed Contract between MTC and Cubic would be the closing date of the Assignment Agreement.

Recommendation

Staff requests that the Committee refer to the Commission for its approval:

(i) An Assignment Agreement and Related Transactions among MTC, Motorola, ERG and Cubic, that will result, when all of the conditions in the agreement are met, in the assignment of the TransLink® Contract by Motorola to Cubic and the settlement of the *MTC v Motorola* lawsuit, including payment of MTC's attorneys' fees and costs; and

(ii) A delegation of authority to the Executive Director or his designee to negotiate and enter into a new Conformed Contract, in the form of Change Order No. 118, between MTC and Cubic, which includes the revisions described in this memorandum and its attachments, subject to the satisfaction of the closing conditions in the Assignment Agreement and effective upon the closing date of the Assignment. The total increase in the Contract amount represented by such Change Order shall not exceed $1.2 million; an amount not to exceed $33.5 million shall be added to the Contract by Change Order after the Assignment.

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Steve Heminger

Attachments (3)

SH:AF:MJM

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Attachment 1

Background and Key Events Leading to Request for Assignment
Of TransLink® Contract by Motorola to Cubic

In June 1999, MTC awarded a contract to Motorola, Inc. to design, build, operate and maintain the TransLink® fare payment system. The work was to be accomplished by Motorola and its primary subcontractor, ERG Ltd. The Phase I limited-deployment pilot concluded successfully in September 2002. Design Build for Phase II has been completed for five operators: Golden Gate, AC Transit, San Francisco MTA, Caltrain, and BART. Design Build for the remaining core operators (VTA and SamTrans) is expected to conclude in 2010. The Operations and Maintenance term of the Contract ends in 2019.

In March 2001, Motorola closed down its smart card business and dissolved its business alliance with ERG. In September 2002, concurrent with the successful conclusion of the limited-deployment TransLink® pilot, Motorola requested an assignment of the Contract to ERG. MTC did not consent to the assignment either in writing or orally, primarily because of ERG's declining financial condition and its failure to commit sufficient resources to the Contract to deliver the system on time. However, project design and implementation continued, with ERG performing the work and Motorola signing contract change orders and submitting invoices.

In late 2005, Motorola asserted that MTC had constructively approved assignment of the TransLink® Contract to ERG, based on MTC's dealings with ERG and unilaterally reduced a $3,000,000 letter of credit (LOC) securing its performance to $1.5 million. The Commission filed a declaratory relief action in federal district court against Motorola in March 2006 to establish that Motorola continues to be the prime contractor on the TransLink® Contract and to require Motorola to restore the full $3,000,000 LOC. The district court granted MTC's motion for judgment on the pleadings on January 31, 2007. Motorola appealed to the Ninth Circuit, and a hearing was held on October 23, 2008. MTC is still awaiting a ruling by the court.

At various points during the Phase II design and implementation, MTC considered terminating the TransLink® Contract for default. MTC retained outside counsel, Glynn & Finley, to evaluate its legal position with respect to Motorola and to advise MTC regarding the most beneficial and prudent course. Staff and legal counsel now believe that approval of the actions before you today is the best way to preserve and build on the Commission's and federal government's investment in TransLink®.

The following table outlines key events leading up to this request for assignment.

Date	Key Event or Activity
June 1999	MTC and Motorola enter into contract for Motorola and its subcontractor, ERG Ltd., to design build operate and maintain the TransLink® fare payment system in the San Francisco Bay Area
March 2001	Motorola exits smart card business and assigns work to ERG, remaining as prime
Dec 2001	ERG posts net loss after taxes for six months ending December 31 2001 of approximately $200M AUS; ERG's stock price falls from a high of $27AUS/share in 2000 to $.23AUS/share immediately after its $200M loss is posted
March 2002	Phase I Pilot begins
Sept 2002	Motorola asks MTC to agree to assign the TransLink® Contract to ERG. MTC does not agree to assignment Phase I pilot successfully concludes
Jan 2003	MTC negotiates changes to the TransLink® Contract that make bankruptcy or insolvency of ERG grounds for termination for default and improves MTC's rights to project assets in the event of ERG bankruptcy, including software escrow
Nov 2003	Notice to Proceed with Phase II and execution of Change Order No. 045, including a mutual release of claims
Sep 2004	Letter of Breach to Motorola, identifying deficiencies in contract performance and areas in which project management had not adequately supported project delivery and requesting a detailed plan for cure to be received within 30 days from the date of the letter
Oct 2004	ERG responds to letter of breach on behalf of Motorola; MTC and Consortium determine that plan represented good faith effort to return to schedule compliance
June 2005	MTC contracts with Glynn & Finley to provide legal services in connection with claims resolution and contractor performance issues
August 2005	Letter to Motorola citing late delivery and inadequate ERG resources and project management and demanding dedication of resources by Motorola and resumption of active prime contractor role
Nov 2005	Motorola letter asserting de facto approval of assignment of TransLink® Contract by MTC due to acceptance of performance by ERG
Feb 2006	MTC learns that $3M Letter of Credit (LOC) required by TransLink® Contract has been unilaterally reduced by Motorola to $1.5M; asks Motorola to restore. Motorola declines but offers to have ERG restore balance

March 2006	MTC brings declaratory relief action in federal district court, seeking declaration that Motorola is prime TransLink® Contractor and the restoration of the $3M LOC.
Nov 2006	First 2 Transit Operators (Golden Gate and AC Transit) reach Revenue Ready, respectively 19 months and 15 months behind schedule
Jan 2007	District Court rules in favor of MTC on motion for judgment on the pleadings
April 2007	Motorola appeals District Court decision to Ninth Circuit and furnishes bond in the amount of $1.5 million to secure the district court's judgment during the pendency of the appeal.
May 2007	MTC initiates 25% withholding on all payments due, based on late delivery in excess of 90 days, per Contract.
Jan 2008	Sydney, Australia's Public Transport Ticketing Corporation's (PTTC) terminates its Tcard contract with ERG for default and sues for $74,000,000 in damages; ERG counterclaims for damages in the amount of $250,000,000
Feb-Mar 2008	ERG announces a six-month Net Loss After Tax for the period ending December 31, 2007 of $104.7 million and a corporate restructure that will leave Sydney litigation as only asset of ERG Ltd; year-end report notes that ERG's liabilities exceed its assets by $7,466,000 as of December 31, 2007 and ERG's auditor, Deloitte & Touche, notes existence of a "material uncertainty … which may cast significant doubt" about ERG's ability to continue as a going concern; ERG's stock price of $.09AUS/ share falls to $.04AUS/ share, and ERG asks the Australian stock exchange to suspend trading of its stock.
May 2008	MTC advises Motorola and ERG that proposed restructure would constitute Termination for Default Event under TransLink® Contract; repeats demand for financially secure contractor
Aug-Sept 2008	Caltrain and SFMTA reach Revenue Ready Status, respectively 20 and 35 months late.
Oct 2008	Hearing on declaratory judgment appeal before the Ninth Circuit.
Dec 2008	MTC, Cubic and ERG begin discussions regarding assignment that will result in settlement of MTC. v. Motorola lawsuit.

Attachment 2

Cubic Transportation Systems

Cubic Transportation Systems (CTS) is a wholly-owned subsidiary of Cubic Corporation. Cubic is traded on the New York Stock Exchange (CUB). Its stock price as of May 1, 2009 is $28 per share.

CTS designs, develops, supplies, installs and support fare collection equipment and central computer systems for all modes of public transit. Although Cubic's strength is in Asset Management, Engineering Services and Installation Services, including deployment, the services component of CTS' business is also significant. About one-half of its current employee base provides services to its customers.

Subject to customer approval and the satisfaction of certain project-related criteria, Cubic expects to buy the assets of ERG USA that related to TransLink® in San Francisco and to operations and maintenance service contracts provided to agencies in Seattle, Washington, D.C., Ventura County, Las Vegas and Boston. This represents a significant growth in the service side of Cubic's business, and it is Cubic's intent to merge Cubic and ERG staff into a consolidated services group. ERG's strength is in Patron Call Center and Support, Card Services, and Institutional Programs. As a consolidated group, Cubic will be able to build on the complementary attributes of Cubic and ERG and further expand its engineering services and back-office operations.

Cubic Corporation posted revenue for the year ended September 30, 2008 of $881 million; net income of $37 million; a net worth of $389 million and working capital of $279 million; and cash and liquid assets of $113 million. During the first quarter of the company's fiscal 2009 compared to the corresponding period in 2008 it reported a 20% increase in revenues and a 32% increase in net income. Cubic's latest forecast shows an end of the year backlog of work in CTS of over $800 million. The company maintains a strong financial position of cash exceeding debt for the most recently released December 31, 2008 financials by $66 million and having a debt to capital ratio of six percent.

Attachment 3

Key Contract Changes

1. Resolution of outstanding claims and disputes (Change Order No. 118):

   - Price Adjustment: Apply 20% discount to adjustment of O&M prices (pursuant to Article 13.6 of the Contract) to reflect project delay.

   - Third Party Load Fee: Set Third Party Load fee at 1.75% and implement installation fee of $3000 per site for third party retailer set-up. Redirect funding from 3rd Party load fees and merge with six separate fees to establish compensation for cardholder support services based on the volume of active cards. Establish bonuses and abatements based on service level standards.

   - Assurance payments: Begin at contract assignment until program reaches 20 million transactions/month.

   - Regional Cycle Test and BART Delay of IIT: Contractor drops claims and agrees to waiver of additional claims against all operators in exchange for elimination of rebates for non-TransLink transactions processed through Concord facility.

2. Move Final Acceptance from completion of Phase 2.5 to completion of Phase 2.4, following completion of VTA and SamTrans Revenue Ready, punch list, acceptance testing and conditional acceptance. MTC's rights to software vest at Final Acceptance. (Change Order No. 118)

3. Phase 2.5 (remaining operators) becomes Phase 3, to be defined in an MTC-issued change notice within 180 days of conformed contract. Remaining operators would be grouped into four installations by corridor, business rules and products would be defined by each corridor group based on existing fare products. (Change Order No. 118)

4. Refer to the following anticipated change orders to be added to Contract following assignment and during the 2009 calendar year:

   - "Non-Transit Applications", including parking and other expanded uses of the TransLink® card. Near term implementation to include the SFMTA pilot at five garages, followed by BART parking. (NTE $1 million)

   - Employer Program: Establishes funding for start-up costs in exchange for reduced employer fees and shared revenue in excess of amount required to cover contractor expenses. Adds new web site functionality. (NTE $2.5 million)

- Accelerate two program investments (device memory upgrade and transition to contactless cards) to position the program for anticipated customer card demand and transaction volumes. (NTE $5 million each)

- TransLink-only faregate equipment and development of next generation of vending equipment for limited use cards. (NTE $20 million)

- No-cost change order to improve data store.

- Contractor to credit first $2 million in BART parking change order back to MTC.

5. To strengthen penalties for contractor delay, revise the list of Mandatory Milestones to eliminate progress payments and to require full satisfactory delivery of each milestone prior to payment.

   Mandatory Milestones in Change Order No. 118 will be:

   - Phase 2.4 Complete for VTA and SamTrans
   - Phase 2 Final Acceptance
   - Phase 3 Complete
   - Phase 3 Final Acceptance

   Anticipated Change Orders with Mandatory Milestones:
   - SFMTA Parking Pilot
   - Employer Program
   - Device Memory Upgrade
   - Contactless Cards
   - Regional Pass Accumulator
   - Muni Metro Equipment

6. Reevaluate transaction pricing in FY2011/12 (Change Order No. 118).

7. Reduce performance bond from $40 million to $10 million for Phase II to eliminate cost of over-bonding and increase Letter of Credit from $1.5 million to $3 million to align better with remaining design-build and future project risk. Require Phase III and other new design-build change orders to include bonding. (Change Order No. 118)